Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket 96-45
	)	

To: The Federal-State Joint Board

COMMENTS OF SPRINT CORPORATION

Sprint Corporation, on behalf of its incumbent local telephone companies ("ILECs"), competitive local telephone, wireless, and long distance operations, submits its comments in response to the Federal-State Joint Board's Public Notice seeking comment on certain of the Commission's rules relating to high-cost universal service support.[1]

Sprint, as a net contributor to the universal service fund and as a wireline and wireless ETC, strongly supports competitively neutral measures to limit the growth of the high-cost universal service fund. Sprint's comments respond to four specific issues raised in the Public Notice referenced above: (1) forward-looking economic costs, (2) study area consolidation, (3) rural telephone company definition, and (4) the level of universal service fund support for transferred exchanges. In addition, Sprint comments on the pitfalls of using averages as a basis for fund distribution when attempting to control the growth of the Universal Service Fund.

[1] See *Federal-State Joint Board on Universal Service*, Public Notice, 19 FCC Rcd 16083 (2004), ("Public Notice").

I. Forward-looking Economic Costs

The Joint Board seeks comment on whether the rural support mechanism should utilize forward-looking economic costs or embedded costs when calculating support dollars for rural carriers. Since the passage of the 1996 Telecom Act, Sprint has consistently stated that forward-looking economic costs ("FLEC") are appropriate to use when determining explicit universal service support, for two specific reasons: 1) forward-looking costs send the proper signals to potential entrants regarding the cost of entering a market and, more importantly, 2) embedded costs that reflect rate of return regulation will incorporate the perverse incentives to reward inefficiency that are inherent in that type of regulation. However, Sprint has also stated consistently that in order to serve as an effective signal to entrants, forward-looking economic costs must be estimated accurately. For FLEC to be estimated accurately, it is necessary for the cost calculation to include all the factors that cause variations in costs: factors that vary with the area being served, as well as factors that vary with the size of the company serving the area. Inputs to a cost calculation—such as purchase prices for outside plant materials—often vary significantly depending on the size of the company that is doing the purchasing: companies purchasing smaller volumes of materials also receive smaller discounts on purchase prices. The Commission itself has made explicit reference, with regard to the purchase of equipment, to the "superior buying power" of larger carriers.[2] This variation in costs does not reflect inefficiencies on the part of the company; rather it reflects the simple realities of market-based prices characterized by volume discounts available to companies with sufficient scale.

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[2] See *Federal-State Joint Board On Universal Service* and *Forward-Looking Mechanism for High Cost Support for Non-Rural ILECs,* CC Docket Nos. 96-45, 97-160, Further Notice of Proposed Rulemaking, FCC 99-120 (¶ 78), (rel. May 28, 1999).

Sprint is unaware of the existence of *any* set of national inputs that could be used in any cost model or costing tool—including the FCC's Synthesis Model—that is capable of adequately capturing these cost-drivers for all rural companies. Accordingly, until a reliable set of inputs is developed, Sprint believes that there is little choice but to use company-specific actual costs in determining federal USF support for rural carriers. However, Sprint believes that a proper and useful balance can be maintained between the *appropriateness* of forward-looking costs and the *availability* of actual costs if the Commission remains mindful of the difference between actual costs incurred under price cap regulation and actual costs incurred under rate of return regulation.

As stated above, actual costs incurred under rate of return regulation reflect the perverse incentives to reward inefficiency that characterize rate of return regulation. Conversely, price cap regulation produces incentives for carriers to operate efficiently, the same incentives that an effectively competitive market produces. Forward-looking economic costs also reflect the same efficiencies produced by a competitive market.[3]

Accordingly, it is much more likely that a price cap company's actual costs would, on average, come closer to reflecting the efficiencies contained in forward-looking costs than a rate of return company's actual costs would. Therefore, although Sprint believes the Commission must continue to use actual costs until an accurate and appropriate forward-looking mechanism is created, the actual costs that should be used should be those of price cap companies, not of rate of return companies.

Toward this end, Sprint recommends the following: As part of a comprehensive reform of the federal universal service mechanism, the Commission should continue to use actual costs for

[3]See, for example, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 15846 (¶ 679), (1996).

rural carriers but should initiate a process to move toward forward-looking costs by benchmarking the average costs incurred by rural rate of return ILECs against those incurred by similarly-sized, similarly-situated rural price cap ILECs.[4] The Commission should establish a range of reasonableness around the costs incurred by price cap ILECs, and then establish support for all rural carriers based on those costs.

For example, a rate-of-return ILEC serving approximately 20,000 access lines, serving a study area with an average density of 50 lines per square mile, with an average loop length between 10,000 and 15,000 feet, would have its costs benchmarked against a similar price cap LEC. A range (for example, 15% above or below) would be established around the price cap LEC's costs. If rate of return ILECs produce costs that fall significantly outside of this range of reasonableness, the individual ILEC could—at its discretion—petition the Commission for support based on its own costs. Absent such a petition, the rate-of-return ILEC would receive support based on the efficient price cap LEC's costs. This process would move the entire federal mechanism closer toward the desired goal of using forward-looking costs; that is, the goal of not rewarding inefficiency. At the same time, it would allow legitimate variations in cost—those not captured by a one-size-fits-all model-based approach—to be supported. This proposal would have the immediate effect of capturing the spirit, if not the letter, of the FCC's desire to move rural carriers toward the use of forward-looking costs.

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[4] As stated above, both the size of the company and the area being served can cause legitimate variations in costs. That is why the price cap LEC against which the rate of return LEC would be benchmarked must be of similar size—easily measured by access lines—and similarly situated. Since density and average loop lengths are key drivers of cost variation for all carriers, including rural carriers, the term "similarly situated" could be determined looking at relative densities of carriers, relative average loop lengths, plus other factors the Commission may deem appropriate.

II. Consolidation of Study Areas

The Joint Board also seeks comment on the concept of consolidating multiple study areas within a state. Specifically, the Joint Board asks "[t]o what extent does a carrier operating multiple study areas in a given state achieve some economies of scale that are not reflected in high-cost support calculations based on separate study areas, and whether considering all of a company's study areas within a state… [would] better reflect the appropriate economies of scale achieved by the carrier?"[5] The short answer is that if the carrier allocates its costs properly, the economies achieved by operating in multiple study areas within a state, or indeed, in multiple states, are properly reflected in the costs assigned to each study area. Combining study areas for purposes of calculating high-cost support would introduce the very kind of implicit subsidies § 254 intended to eliminate.

Sprint operates as an ILEC in eighteen states, and in four of those states Sprint's serving territory is made up of more than one study area. It is Sprint's experience that the costs estimated by carriers in these situations *do* accurately reflect any scale economies that are achieved, regardless of the level of averaging or de-averaging. The costs assigned to each study area reflect the economies of Sprint's overall purchasing power. The cost allocations also reflect operational economics as well. For example, Sprint's serving territory in Texas consists of two separate study areas. But Sprint does not utilize separate workforces that are assigned to each study area; rather, the costs of Sprint's workforce are allocated across the two study areas and reflect the economies that result from having a single workforce. Consistent with this fact, when costs are calculated at any level—for example, at the wire center level—there is no reason to believe (or evidence to

[5] Public Notice at ¶ 12.

suggest) that the economies of scale that companies enjoy *across* wire centers are not accurately reflected. The same is true when costs are calculated at an individual study area level.[6]

To the extent that different study areas within a state have different underlying costs, e.g., because of differences in density, terrain and loop length, consolidating study areas would require a lower cost study area to subsidize a higher cost study area. The problem with this approach is that, as the Commission itself has stated, implicit subsidization is inconsistent and unsustainable in competitive markets.[7] Since the passage of the 1996 Act, the Commission has made steady progress toward eliminating implicit subsidies for both rural and non-rural carriers. To consolidate carriers' study areas within a state for purposes of federal USF calculation would be a significant step backwards in this effort; it would be increasing levels of implicit subsidization. Instead, it should continue to minimize or eliminate them in favor of explicit subsidies, consistent with the objective of making support explicit, sufficient and predictable.

Sprint has consistently urged that the size and growth of the fund must be controlled, in order to avoid placing an excessive burden on end users through the USF assessments that are ultimately incurred by them. However, the most efficient and competitively neutral way to control the size of the fund is not through the type of arbitrary averaging that would be produced by study area consolidation. The most efficient and competitively neutral way to control the size of the fund is to reduce the *need* for explicit support by allowing more of the required revenue to come directly from the end user. This means allowing local rates in rural areas to come closer to covering the

[6] In fact, the same principle is true with regard to economies of scale realized across multiple states. The actual study area costs of companies that operate in multiple states reflect any economies that the companies realize across the states. For example, the overhead costs built into Sprint's cost estimates for its Ohio serving territory reflect the economies that Sprint realizes by serving regions in Ohio, neighboring Indiana and all other states served by Sprint. The same is true with regard to purchasing power and vendor price negotiations, which are leveraged nationally wherever possible.

[7] See *In the Matter of Access Charge Reform, et. al., 15 FCC Rcd 12962, 12972*, (¶ 24) (2000).

costs of service. This can be accomplished by recognizing and correcting for a fundamental disconnect that exists in the current system: The existing system simply assumes—without any evidence or analysis—that customers cannot be asked to pay rates that actually cover the costs of serving them *or even come closer* to covering the costs of serving them. Sprint strongly believes that a comprehensive reform of the federal universal service system should include mechanisms that would incent states to increase local rates in rural areas to cover more of the costs of providing service. Allowing rates to move toward costs would not only reduce the need for subsidies, but would also send correct signals to potential market entrants who currently are forced to compete against artificially suppressed rates, broadening the reach of competition.

III. Definition of Rural Company

The Joint Board also seeks comment on whether to modify the existing definition of "rural" carrier. Before the Joint Board should consider a re-definition of a "rural" company for universal service purposes, it would do well identify exactly what such a re-definition would accomplish. If the desired effect of redefining a "rural" carrier were to exclude certain carriers from receiving support in order to control the growth of the fund, Sprint would strongly suggest that there are more effective, more efficient ways to achieve this goal.

In discussing the re-definition of "rural" carrier the Joint Board offers several options regarding the use of company size as a distinguishing factor among rural companies. The Joint Board asks whether it should use finer distinctions in company size and whether these finer distinctions in company size would "be more useful in effectively targeting universal service support to rural carriers serving the highest cost areas?"[8] Sprint respectfully submits that the size of

[8] Public Notice at ¶ 15.

the carrier whose costs are being estimated has no effect on the Commission's ability to target support. Evidence of this is clearly available from the Commission's current approach to supporting non-rural carriers: Support is calculated for the largest carriers based on comparing statewide average forward-looking costs to a national benchmark. Once calculated, the support is then allocated (targeted) based on individual wire center costs. The Commission requires no "finer distinction" regarding the size of the company to achieve this targeting, only a finer distinction of cost calculation.

In general, Sprint is unable to identify any specific purpose that might be served or goal that might be achieved by adopting a different definition of "rural" carrier for purposes of determining eligibility for explicit universal service support. Goals such as controlling the fund size or more effectively targeting support can be achieved through other means in a more competitively neutral manner.

A special note: In discussing this issue, the Joint Board explicitly identifies Sprint's operations in Florida as an example of the type of company that calls into question the existing definition of rural carrier, because Sprint's Florida operations serve a large number of access lines in total. Sprint welcomes the opportunity to respond to this issue on several levels.

First, Sprint-Florida does not receive a single dollar of support from any of the federal high-cost funds providing support to rural carriers (high-cost loop, local switching, long-term support, etc.).[9] So while the Joint Board might have reasons to believe that the existing definition is problematic—because under that definition Sprint-Florida is considered rural—those reasons cannot include a claim that the existing definition contributes to problems regarding the size of the fund. The current problematic size of the fund is a function of many factors—the reluctance of regulators

[9] Sprint-Florida does receive interstate access support ("CALLS" support), which is generally provided to non-rural companies.

to move retail rates closer toward costs, the fact that support is based on inefficient rate-of-return based costs, the fact that support is not targeted to specific high-cost areas—but the size of the fund is not a function of a definition that classifies Sprint-Florida as a rural carrier.

Second, Sprint-Florida has never taken advantage of any rural exemption available to it with regard to unbundling or interconnection. So again, any problems the Joint Board perceives regarding this definition (because it includes Sprint-Florida) cannot be based on issues regarding competitive neutrality. Furthermore, Sprint-Florida serves some of the most rural, isolated, and high-cost regions in the entire state of Florida, including many wire centers in the Florida Everglades. Given these facts, it is unclear exactly what the source is for any concern on the part of the Joint Board that Sprint-Florida qualifies as a rural carrier.

IV. Support for Transferred Exchanges

The Commission's rules regarding USF high-cost support for transferred exchanges[10] are effective. The public policy goal to be achieved by these rules is that USF support should not be a factor in a LEC's acquisition or divestiture decision. The current rules requiring an acquiring LEC to receive the same amount of USF per-line support as that received by the divesting LEC, in addition to the Commission's safety valve provisions for rural LECs,[11] serve to minimize the impact of USF in an acquisition or divestiture decision.

V. The Impact of Averaging on Support Calculation

The Joint Board notes that the size of the area over which costs are averaged and the national average cost benchmark used in the non-rural mechanism have more impact on

[10] 47 C.F.R. § 54.305.
[11] See *Rural Task Force Order*, 16 FCC Rcd at 11281-93, (¶¶ 91-119), (2001).

determining overall support levels than whether those costs are forward-looking or embedded.[12] Sprint wholeheartedly agrees, and would encourage the Joint Board to recognize that cost calculation is a necessary component of—but a separate exercise from—support calculation. Following that fact, any suggestion that a specific type of cost calculation would, in and of itself, result in a reduction of support for any specific carrier or type of carrier is without foundation. Sprint further notes that while averaging costs over larger areas has the effect of reducing the fund size (a desirable outcome), it also has the effect of expanding implicit cross-subsidization (a prohibited outcome.) Given this trade-off, Sprint again reiterates its recommendation that if one of the Joint Board's primary goals is to control the overall size of the fund, increased averaging and increased reliance on implicit subsidization are not the optimal ways to achieve it. Rather, if rural rates are allowed to move toward costs, thereby reducing the need for explicit subsidy, federal support could be adjusted accordingly, and the size of the fund would be reduced. This is a competitively neutral, efficient method for achieving the Commission's goal.

Respectfully submitted,

Sprint Corporation

By Jeffrey L. Lindsey
Brian K. Staihr, Ph.D.
6450 Sprint Parkway
Overland Park, KS 66251

Jeff Lindsey
Richard Juhnke
401 9th St. NW
Washington, DC 20004
(202) 585-1921

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[12] Public Notice at ¶ 41.

CERTIFICATE OF SERVICE

I hereby certify that a copy of Sprint Corporation's Comments in CC Docket 96-45 were sent by electronic filing on this the 15th day of October, 2004 to the following parties.

Sharon Kirby

Sharon Kirby

BY ELECTRONIC MAIL

Marlene H. Dortch, Secretary
Federal Communication Commission
445 12thStreet, SW
Room TW-A325
Washington, DC 20554
Marlene.Dortch@fcc.gov

BPCI
The Portals
445 12th Street, SW
Room CY-B402
Washington, DC 20554
Bcpiweb.com

Narda Jones
Federal Communications Commission
Division Chief, TAPD
Wireline Competition Bureau
445 12th Street, SW
Washington, DC 20554
Narda.Jones@fcc.gov

Sheryl Todd
Federal Communications Commission
TAPD
Wireline Competition Bureau
445 12th Street, SW
Washington, DC 20554
Sheryl.todd@fcc.gov